No. 203

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1958

No. 203

UNION OIL COMPANY OF CALIFORNIA AND LOUISIANA LAND AND EXPLORATION COMPANY, *Petitioners*,

v.

FEDERAL POWER COMMISSION, *Respondent*.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

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To the Honorable, the Chief Justice of the United States and the Associate Justices of the Supreme Court of the United States:

Petitioners herein, Union Oil Company of California and The Louisiana Land and Exploration Company respectfully pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fifth Circuit entered April 23, 1958 in the above-captioned case.

OPINIONS BELOW

The opinion of the Court of Appeals (App. 1a)[1] is not yet reported. The pertinent opinion and order of the Federal Power Commission are shown in the Joint Appendix, pp. 554-580 and are reported at 16 PUR 3rd 112.

JURISDICTION

The judgment of the Court of Appeals was entered on April 23, 1958 (App. 12a). Jurisdiction was conferred upon this Court by 62 Stat. 928, 28 U.S.C., Section 1254(1), and Section 19(b) of the Natural Gas Act, 52 Stat. 821; 15 U.S.C., Section 717 r(b).

QUESTIONS PRESENTED

1. Is a permanent, definite and fixed contract price for natural gas sales, when competitively negotiated between non-affiliates at arms-length and in time prior to June 7, 1954, to be effective at a date immediately subsequent thereto, an initial rate upon being filed which is beyond the power of the Federal Power Commission to suspend under Section 4 of the Natural Gas Act?

2. Are the Federal Power Commission orders Nos. 174-A and 174-B as supplemented by its suspension orders here, valid and lawful exercise of authority, when such orders operate to deprive Petitioner of its statutory and constitutional right to the permanent, definite and certain contract price for natural gas which was competitively negotiated prior to the issuance thereof?

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[1] "App." refers to the appendix to this petition.

3. Is the use of the traditional rate-base method of rate determination required under law by your Petitioner for purposes of demonstrating the justness and reasonableness of the rate here involved, when the sales represent a relatively minor segment of its corporate operations?

4. Does the law proscribe the use of competitively established field prices as substantial evidence upon which to base an administrative finding by the Federal Power Commission that a comparable price under its review is just and reasonable within the intendment of the Natural Gas Act?

STATUTE INVOLVED

The pertinent provisions of the Natural Gas Act, June 21, 1938, C. 556, 52 Stat. 821, 15 U.S.C. § 717 *et seq.* are set forth in App. 12a.

STATEMENT OF THE CASE

On September 26, 1957, petitioners filed in the Court below their petitions under Section 19(b) of the Natural Gas Act to review and set aside certain orders of respondent. These several orders are respectively designated as:

1. Order No. 174-A (19 F.R. 5081 of August 12, 1956), and Order No. 174-B (19 F.R. 8807, of December 23, 1954) (R. 327-346, 416-444).
2. Order Suspending Proposed Changes in Rates (R. 389-394).
3. Opinion No. 300 and Accompanying Order (R. 554-580).
4. Order Denying Petition for Rehearing and Amending Order Accompanying Opinion No. 300 (R. 586-602).

1. *Orders:* Simply put, respondent by its orders under items Nos. 1 and 2 suspended the effectiveness of petitioners' contract price for the sale of natural gas. This price was negotiated prior to June 7, 1954, the date of the decision in *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672 in which this Court held that sales of the character made by petitioners were subject to the provisions of the Natural Gas Act. The period of suspension of this contract price extended from November 1, 1954 to February 1, 1955. Petitioners were thereafter permitted to collect this contract price under the terms of the agreement only upon a tentative basis subject to subsequent refunds and interest. This contract price is still being collected on this basis.

By its orders under items 3 and 4, respondent after extended hearing deemed that petitioners had exhausted to no avail their presentation of proof offered in support of the justness and reasonableness of the aforesaid contract price. Respondent dismissed this effort of petitioners as insufficient upon which to base a finding that the negotiated contract price was in fact just and reasonable within the meaning of the term in the Natural Gas Act.

Upon review, the Court below declined to rule upon the urgent and vital questions here presented and denied petition for review in all respects save one; that is, the petition to the lower Court is granted to the sole extent that respondent is directed to reopen these proceedings to afford petitioners an opportunity to adduce additional evidence (App. 11a).

2. *Background:* Petitioners are engaged in the business of producing oil and gas in a number of areas throughout the United States.

In 1948, a gas sales contract was negotiated by petitioners with Transcontinental Gas Pipeline Corporation, (R. 248-294) a natural gas pipeline transmission company for natural gas produced by petitioners from five southern Louisiana producing areas. This contract contained the usual and customary provisions in common usage in the industry with respect to first party and third party favored nations clauses and a bona fide purchase offer clause (R. 52-55). Its term was twenty years. Deliveries of gas commenced thereunder in 1951.

In 1952, Transcontinental became aware that its future gas supply was in jeopardy and that the contract price for its then present supply was subject to drastic increase (R. 35-36). Other pipeline purchasers were entering the area with offers for natural gas purchase in excess of the contract price contained in the then existing contract with petitioners (R. 36-37). The higher prices being offered, and future price escalations under the third party favored nations contractual clauses would place the future cost of gas to Transcontinental beyond its power to control. (R. 38-39).

Likewise, a dispute arose between the parties as to the effect of an unrelated sale and purchase by others upon the escalated price to be paid petitioners by Transcontinental (R. 40 *et seq.*). Arbitration of this dispute resulted in a settlement between the parties under which an interim price of 8.79¢ per Mcf plus 1¢ per Mcf tax reimbursement was to be effective from July 1, 1952 until November 1, 1954. In addition, the third party favored nations clause in the 1948 contract was to be held in abeyance. (R. 41).

Thereafter, arm's-length negotiations were conducted by Transcontinental and petitioners which resulted in the execution of five superceding contracts on November 17, 1953 (R. 43). In return for a price of 16c per Mcf plus 1c for tax reimbursement, petitioners, in the terms of Transcontinental, gave "very valuable and basic consideration" under these 1953 renegotiated agreements (R. 46-49).

According to the purchaser, Transcontinental, the considerations granted by petitioners in return for the 16c price in the negotiation of the new 1953 agreements have benefited its position immeasurably. Thus, the new contracts would grant, among many other benefits, the following rights (R. 42, *et seq.*):

1. A new extended contract term of 20 years.

2. The deletion of the previously effective third party favored nations clauses.

3. Restriction of the area of influence of the first party favored nations clause to exclude all areas east of the Mississippi River.

4. Dedication under the new contracts of additional gas reserves in the order of 383 billion cubic feet.

5. Increase in maximum daily allowable deliveries to 125,000,000 cubic feet.

6. Fixed and certain prices throughout the 20 year contractual term far below the price of other comparable gas supplies then and now available.

7. At the buyer's option, to purchase under the same fixed price all additional gas supplies developed in the producing areas subject to the contracts.

8. Dedication of approximately 100 billion cubic feet to petitioners' performance under the new contracts.

In short, Transcontinental felt that it "had made a good deal" (R. 36-49).

The 1953 contracts were negotiated upon the basic reliance of respondent's historically consistent repudiation of its jurisdiction, under the Natural Gas Act, of producers and gatherers of natural gas. *Columbia Fuel Corporation*, 2 FPC 200; *Regulation No. 163*, 17 F.R. 7385; *Regulation No. 141*, 13 F.R. 6371.

On June 7, 1954, this Honorable Court rendered its decision in the *Phillips* case, *supra*, p. 4.

On August 6, 1954, respondent without notice or hearing issued its Order No. 174-A with dissent. The order required the filing of initial rate schedules and applications for certificates of public convenience (R. 327-346).

Under protest and with full reservation of rights, petitioners responded in compliance thereto on September 30, 1954. The filings were made by it to avoid the criminal penalties imposed for violations thereof. Included in these filings were all contracts governing the sales to Transcontinental (R. 389-394); that is, the original May 4, 1958 contract (R. 248-284); the September 6, 1952 amendment thereto resulting from the arbitration of the interim 8.797150¢ price per Mcf to October 31, 1954 (R. 284-294); and the November 17, 1953 agreement to be effective November 1, 1954 as cited before (R. 295-327).

3. *History of Proceedings:* On October 29, 1954, respondent issued orders suspending the use of the

November 13, 1953 contract terms, as theretofore negotiated to become effective on November 1, 1954. (R. 389-394). Respondent on December 7, 1954 denied (R. 441-415) petitioners' request for reconsideration and vacation of the suspension orders (R. 394-410). This action was sustained, *Union Oil Company of California and Louisiana Land and Exploration Company*, 236 F. 2d 816, cert. denied 352 U.S. 969, on the general grounds that the orders were then not reviewable.

Hearings on the matters before respondents were first conducted in September 21-23, 1955 in which petitioners by uncontroverted evidence established a mass of substantive detail on the justness and reasonableness including the facts heretofore recited. Intervenors thereafter made motion to dismiss on the general ground that petitioners had not sustained the burden of proof under Section 4(e) of the Act, to show that the prices in the 1953 superceding contracts were just and reasonable. On October 24, 1955, respondent issued its order which deferred action on the motion and referred the proceedings to its Examiner (R. 468-477).

Pursuant to respondent's directive, hearings were resumed before it on November 28, 1955 and petitioners exhaustively established the pertinent evidence applicable to, and in justification of, its 1953 negotiated contract price. This evidence, again uncontroverted, established among many others, the following facts:

> The minimum price of 16¢ per Mcf was required for pipeline purchasers to then secure gas suppliers because the competitively established level in the producing areas in question ranged from 16¢ to 20¢ (R. 122-126). Such gas reserves

several years later, in 1955 were readily sold at 20¢ per Mcf (R. 119).

Further, the contract prices of 16¢ were considered fair and reasonable by the parties. It was a price that resulted in considerably lower end-use customer costs in the terminal markets than were rates of Transcontinental's pipeline competitor (R. 109-111). Petitioners occupied no dominant position in the natural gas producing industry either in Louisiana; in the nation as a whole; or in relation to Transcontinental's total gas purchases (R. 92-97, Exhibits 4, 5, 6, R. 149-153). The 1953 renegotiated contract price of 16¢ per Mcf is less than the price of competing fuels, either coal or oil at the sites of production of such fuels and the places of use thereof (R. 128-129).

On a national basis, additions to domestic natural gas reserves have not maintained pace with the accelerated rate of gas consumption. The rates of proved reserves to net annual production has declined from 32.5 years in 1946 to 22.4 years in 1954 (Exhibits 18 and 19, R. 158, 159, R. 104-105, R. 113-118, Exhibit 31, R. 170-195). Less gas and oil reserve is found per unit of exploratory hole drilled, the costs of which in turn are increasing constantly as deeper drilling is conducted in more inaccessible areas (R. 115-120).

The incentive for exploration and development of new gas reserves is directly geared to the prices which the producers can expect to market the proceeds which are on statistical basis infrequently encountered (R. 106-107, 114). A reasonable level of compensation is necessarily required, as well as removal of the uncertainties of the present state of the law upon which prices will be determined in the administrative forum, in order to stabilize the industry and permit orderly and timely development of natural gas reserves (Tr. 215-216).

Intervenors renewed motion to dismiss on November 30, 1956 which was referred to respondent on December 2, 1956. Respondent by order issued January 23, 1956 postponed its action on the motion, and pursuant to notice of resumption, the proceedings were reconvened for hearing on March 14, 1956. Petitioners' having concluded the direct cases-in-chief, rested. No other party introduced evidence and the hearing was concluded. Motions to dismiss were renewed by intervenors and respondent's staff.

On March 22, 1956 while the case was pending before the respondent's Examiner petitioners filed a motion to dismiss the proceedings for lack of jurisdiction (R. 481-484) upon authority of the decisions of this Honorable Court in *United Gas Pipeline Company* v. *Mobile Gas Service Corporation*, 350 U.S. 332, and *FPC* v. *Sierra Pacific Power Company*, 350 U.S. 348 (1955). On April 26, 1956, respondent referred this motion to the Examiner for ruling as a part of the initial decision in the matter.

The initial decision issued on May 2, 1956 (R. 486-543). Intervenor's motions to dismiss were therein sustained solely upon the absence of evidence of costs of service to support the 16 cent price per Mcf contained in the 1953 superceding contracts. Petitioners' motion to dismiss on jurisdictional grounds was denied.

After exceptions filed and argument had, the respondent's order accompanying its divided opinion No. 300 [1a] (R. 554-580) issued December 6, 1956. *This order also imposed upon petitioners each and every obligation and condition of the new and superceding contracts of November 17, 1953, but denied to them the*

[1a] *Union Oil Company of California* (Opinion 300) 16 F.P.C. 100.

only consideration therefor flowing to them, namely, the increased price for which they had contracted to furnish the new services and impressive benefits to Transcontinental.

Opinion No. 300 announced for the first time that the *City of Detroit* criteria obtained in producer proceedings. *City of Detroit* v. *FPC*, 230 F. 2d 810 (CADC) *certiorari* denied, 352 U.S. 829.

After petitions for rehearing filed on January 4, 1957 (R. 585-586) and denied by respondent on January 31, 1957 (R. 586-600) and February 8, 1957 (R. 601-602), petition for review was filed in the lower court on March 27, 1957, under Section 19(b) of the Natural Gas Act and Section 10 of the Administrative Procedure Act for relief cited before; that is for review and to set aside respondent's dismissal, suspension orders and series 174 orders; that respondent be directed to reopen the proceedings with leave to petitioners to adduce additional evidence deemed necessary to support the justness and reasonableness of its 1953 contract prices of 16¢ per Mcf.

The decision of the lower Court to which this petition for writ of certiorari is directed appears in App. pp. 16a 40a.

REASONS FOR GRANTING WRIT

The questions here presented are vital to the immediate interests of the natural gas industry and to the large segments of the public which it serves. In the present state of uncertainty and confusion of the law, the Federal Power Commission, the natural gas suppliers and producers, the natural gas transmission pipeline companies, the natural gas distributors, and the natural gas customers so served are largely operat-

ing in undefined areas of arbitrarily established ambits.[2] Each phase of the industry and public is penalized by non-direction, to the certain and positive injury of the aggregate. Such chaotic circumstances particularly since it is grounded in the erroneous interpretations of recent decisions of this Court[3] urgently necessitates advice and direction by review here.

1. Respondent Erroneously Considered the November 17, 1953 Initial Contract Prices as Changes in Rate. (R. 2391-94).

The November 17, 1953, contracts were tendered for filing under protest and duress by petitioners on September 30, 1954 and did not constitute any change in either . . . "rate, charge classification or service effective or applicable to a sale subject to the jurisdiction of the

[2] The Federal Power Commission in a recent opinion stated the current circumstances thusly: (App. 16a).

> ". . . The complexity of the problems which have arisen in these (producer) cases has been such that although several of the cases have been in progress for nearly three years, although the Commission has been using every means available to expedite them, and although the Staff and parties have been at all times diligent in prosecuting them, not a single proceeding has yet been submitted to a presiding examiner for his final decision. . . . These attempts to use this (rate base) method have resulted in great expense which ultimately must be borne by the consuming public, have caused great confusion in the industry, have led to the withholding of some gas from the interstate market a probable result of which has been in increased prices for the remaining supply, and have led to many other results detrimental to the public interest . . . (Parenthesis added).

[3] *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672, *City of Detroit* v. *FPC*, 203 F. 2d 810 (CADC) *certiorari denied*, 352 U.S. 829, *United Gas Pipeline Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332, *FPC* v. *Sierra Pacific Power Co.*, 350 U.S. 348.

Commission as of June 7, 1954 . . ." (R. 330). The November 1953 contracts by uncontroverted evidential facts contemplated a rendition of service entirely distinct and completely foreign—save in two immaterial respects—to the service rendered Transcontinental by petitioners on June 7, 1954. The two sole points of similarity in the two separate services are simply that both provided for the sale of natural gas from Louisiana production areas, and that the parties to the contracts were the same. In all material respects, the November 1953 contracts were in matters of fact and law, the initiation of a new, previously unconducted sale of natural gas to an existing customer. These were timely filed in accordance with the terms and within the spirit of § 154.92(b) of Order No. 174-A (R. 329).[4]

Just as the November 1953 contracts which have been suspended provided for entirely *new* and *different*, as contrasted with *changed* service, that was in effect for a temporary period under the September 1952 interim agreement, so also are the differences between the two services myriad in character and consequence.

Thus, the November contracts (R. 295 *et seq.*) by contrast to the interim arbitrated agreement (R. 248 *et seq.*) provided for prices which are fixed and certain,

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[4] § 154.92(b) provides in pertinent part: (R. 329)

"Every independent producer who, subsequent to the effective date of these rules, *proposes to initiate* an interstate transportation or *sale* of natural gas subject to the jurisdiction of the Commission *to an existing* or new customer shall file with the Commission not less than 30 days nor more than 60 days prior to the date of such transportation or sale is proposed to be initiated a rate schedule as defined in Section 154.93 hereof. . . ." (Emphasis supplied).

and not subject to third party favored nation influence (R. 41, 398); a completely new term of service (R. 265-313); different points of delivery (R. 265-313-4); completely dissimilar contract quantities (R. 253, 298, 1514); unrelated magnitudes of reserves dedicated to performance (R. 256-57, 295-96); the area of influence of the first party favored nations contractual clause was radically restricted (R. 46); additional facilities were required to implement the deliveries (R. 42-44; 207, 213).

In short, no material similarity in fact or law exists as to the rights and duties of the parties under the November 1953 contracts providing for prices of 16¢ per Mcf, and the arbitrated amendment dated September 6, 1952 (*Supra*). No more did the latter amendment bear legal or factual resemblance to the original contract of May 4, 1948 (*Supra*).

To construe as did respondent, the *completely new service* contemplated in the November 1953 contracts as a *change* under the meaning of the words in § 154.94 of its regulations (R. 1546), *of the old service* provided under the September 1952 interim agreement is error of the gravest consequence to petitioners. If its construction were sound and its position were tenable, no purpose would be served by its inclusion of the provision in § 154.92(b) of its regulation, *supra* p. , f.n. 4, *that new services* initiated subsequent to the effective date of these rules would be the subject of a separate filing *in futuro* completely distinct from the filing requirements for *changes* in rate schedules provided in § 154.94 thereof (R. 1546). That § 154.92(b) is effective and operative is as apparent as is the distinction between as *initial service*, the contract terms of which the respondent is not empowered to suspend

under the Natural Gas Act, and a *change* in rate schedules for an existing service subject to the suspension powers contemplated in Section 4(e) thereof.

The vitiation then, by respondent of petitioners' November 1953 initial contract terms for new service under the mistaken application of delegated authority to suspend *changes* in rates for existing service was an unwarranted exercise of power on the facts and law before it.

This Honorable Court has established the rule to be applied here, in *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332, 338;

> "... In construing the Act, we should bear in mind that it evinces no purpose to abrogate private rate contracts as such. To the contrary, by requiring contracts to be filed with the Commission, the Act expressly recognizes that rates to particular customers may be set by individual contracts."

2. The Order 174 A as Supplemented by the Suspension Orders Cannot Lawfully be Applied to Petitioners' Initial November 1953 Contract Prices.

The portions of Orders 174A and 174B which pertain to the regulatory incidents of "changes" in filed rates, charges, classifications or service are set forth below in parallel with respective dates of issuance:

Order 174 A *August 6, 1954* (R. 331)	Order 174 B *December 17, 1954* (R. 425)
The operation of any provision of the rate schedule providing for future or periodic changes in the rate, charge, classification, or service after June 7, 1954, *or the effective date of any rate schedule for initial service after June 7, 1954 shall constitute a change in rate schedule.* (Emphasis provided).	The operation of any provision of the rate schedule providing for future or periodic changes in the rate, charge, classification, or service after June 7, 1954, *or the operation of any like provision in any initial rate schedule filed after June 7, 1954 shall constitute a change in rate schedule.* (Emphasis provided).

Consideration[5] of this revision in language between the orders is dispositive of the question.

Thus, petitioners, by compliance under protest on September 30, 1954 with the mandate contained in Order No. 174-A with respect to filing requirements subjected their position under this compulsion to the definition of change as therein contained. In being subject to the all-inclusive area of the emphasized language of Order 174-A, it was inevitable that its initial rates were subject to suspension under this unlawfully exercised authority. Stated another way, Order 174-A provided for the filing of *no initial rate which was to become effective subsequent to June 7, 1954.* The terms of the order specifically provided to the contrary by definition, for any initial rate schedule which provided

[5] Chronological sequence of respondent's original and revised orders and petitioners' filings are significant to this consideration: (1) Order No. 174-A issued August 6, 1954; (2) petitioners filed under compulsion thereof on September 30, 1954; (3) the suspension orders issued October 29, 1954 under asserted authority of Order 174-A; (4) petitioners filed for reconsideration of the suspension orders on November 12, 1954; (5) Order No. 174-B issued on December 17, 1954 to become effective on that date.

for an effective date subsequent to June 7, 1954 would constitute a change. Through this faulty mechanism all initial rates so filed would be subject to suspension and hearing under the provisions of Section 4 of the Natural Gas Act (App. 13a).

Respondent acted with understandable haste in rectifying this unlawful aspect of its Order 174-A. Notwithstanding, the interim afforded for its deliberation from November 12, 1954, when petitioners' request for reconsideration gave notice of its improper suspension orders, to December 17, 1954 when Order 174-B issued respondent proceeded to regulate petitioners within the precise word and term of this illegal rule. By these acts, not only were petitioners' valid initial contract prices suspended to the end that revenues lost in the suspension period can never be recouped, but these prices to this day continue to be impaled upon this unlawful regulation.

Without question, petitioners' November 1953 contracts provided for an effective date subsequent to June 7, 1954. On the face of the arguments, the terms thereof were to become executory November 1, 1954. Therefore, under the Order No. 174-A provision the November 1953 initial contract price of 16¢ per Mcf plus 1¢ tax reimbursement became a "change". Categorically the effective date of November 1, 1954 was condemnation, and the contract prices were relegated to suspension status thereby.

In belated recognition of this error, respondent's order No. 174-B provided otherwise. The distinction seems slight and was dismissed by respondent as one of ". . . Other minor revisions of a technical or clarifying nature . . ." (R. 419). In effect, nothing could be

of more moment or consequence nor more mischievous of nature. An "effective date . . . for *initial* service" was translated into . . . "the operation of any like provision (providing for future or periodic *changes*)" (Parenthesis added)

It was not to the initial rates of the character filed by petitioners that the thrust of the rules was intended. The future or periodic changes therein contemplated were those which would make for adjustment of the price of a given seller by reason of changes in the prices received by a given purchaser upon resale, or those which arose through adjustment of the price of a seller by reason of the payment of higher prices by other purchasers in the same or other producing areas. (R. 421-22, 433).

Petitioners here do not question the respondent's treatment of any type of escalatory provisions in gas agreements filed as rate schedules before it. What petitioners maintain here is that the suspension of the November 1953 contract prices was an unlawful, unwarranted and arbitrary action, and that it should not be subjected to the penalty thus and there imposed and continuing to this very day. It is clearly deprivation of property without due process as was noted in the learned, reasoned dissent to respondent's Order 174-A (R. 346).[6]

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[6] Respondent clearly recognizes today that even in instances in which indisputable changes in rates occur in the form of increases, suspension is not invariably required in the public interest. (App. 3a).

3. Rate Determination by Traditional Rate-Base Method Is Not Required Under Law for Purposes of Determination That Petitioners' Contract Prices are Just and Reasonable.

Respondent has recently presented an impressive legal critique on this issue which petitioner adopts for purposes of presentation here. (App. pp. 16a-40a) It supports respondent's position there asserted in all features save one—that petitioner in fact and in law should have been accorded the same treatment there provided when its cause came to be heard before respondent approximately four years ago.

As respondent correctly avers:

> "... the rate base method requires a study of the entire operations of each company regardless of whether all or only a part of the company's rates are being fixed. . . . Furthermore, with respect to a natural gas producing company, the exploration and development program of the company as a whole would have to be examined in order to determine the costs of this program allocable to the jurisdictional sales involved. [A] result of the necessity of examining the operations of the company as a whole, a rate case which employs the rate base method is usually a long drawn-out affair. . . ."

The record here shows that the petitioners are engaged extensively in Louisiana and Texas among other states in the exploration, production and sale of oil and natural gas (R. 2, 3, 683). The production of the gas supplies delivered to Transcontinental Gas Pipeline Company under the November 1953 contracts is confined to five fields in southern Louisiana which are located in three parishes thereof. (R. 92-93). These operations represent a relatively small proportion of the petitioners' corporate activities. Similarly, to require under penalty of dismissal that petitioners

present rate base evidence of these broad and divergent activities in support of isolated gas prices which in the first instance have been established at the bottom of the prevailing scale in the particular areas involved (R. 121, 125, 150), is surely an arbitrary demand for more than can reasonably be expected and more than is necessary to support the gas prices here in issue (App. 19a).

In short, there is no discernible distinction between petitioners' cause and that ruled upon by the respondent (App. 16a-40a), the attempts therein stated to the contrary notwithstanding. The arbitrary effort is discriminatory in the extreme, and capriciously prejudicial.

4. Field Price Evidence Is Adequate Under Law to Find Petitioners' Gas Prices to be Just and Reasonable.

The Commission majority has erroneously concluded that *City of Detroit, supra,* is controlling here. It has arbitrarily applied this doctrine, which the Court specifically confined to *such a case* as was then before it. The issue involved a field price allowance to a pipe line company for company-owned production. The parties are entirely dissimilar here, and a sharply negotiated *sale price* is involved not an *allowance* to one corporate self.

Further, as the respondent recognizes (App. p.), the same Court which decided *City of Detroit* recently held in *Mississippi River Fuel Corp. v. Federal Power Commission*, (CADC) 252 F. 2d 619 at 623, *certiorari* denied, 355 U.S. 904, that "a full-blown" inquiry at the outset was not necessary to be conducted into the rates of a producer selling to its affiliate. How much less is required for respondent to insist on

pain of dismissal of petitioners' cause that such a full-blown rate case is essential in the instance of completely unaffiliated parties negotiating a price under extremely competitive and vigorously individual environment.

Moreover, the business of an interstate pipe line is so radically different from that of an independent producer, that imposition of the traditional rate base regulation upon the latter is contrary to the public interests in many respects. The complex problem of regulation of independent producer gas sales calls for a new approach to the subject. There is no possible need, use or function for a rate base "anchor", when no anchor as such is available in this embryonic regulatory area of such recent development.

Respondent, in addition to its most recently stated position on this grave question, has in a number of cases permitted increased rates to become effective on such a mere scintilla of cost showing, that the effort is no more than lip-service to the *City of Detroit* doctrine of requisite cost inclusion. *Davidor & Davidor*,[7] 15

[7] In *Davidor* for example, respondent in reversing its Examiner and granting increase stated:

> ". . . Here again although the evidence relevant to these matters (field price) leaves something to be desired in completeness, it deserves our consideration, and shows that . . . (the proposed rate) . . . is reasonable in comparison with other prices being charged in the area and is, in fact, the 'going rate' (Parenthesis supplied) . . . We do not place great reliance on the cost figures developed in this case as being an infallible indicator of a just and reasonable rate . . . . . Although perhaps leaving something to be desired in completeness[2] applicant's rather empirical presentation is adequate for purposes of this case. . . .
>
> [2] For example, applicant leaves out of account certain items such as income taxes and exploration costs."

F.P.C. 1237 (1956); *Olin Gas Transmission Corporation*, 17 F.P.C. 685 (1957); *Harper Oil Company*, 17 F.P.C. 803 (1957).

CONCLUSION

For the foregoing reasons this petition for a writ of certiorari should be granted.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I, George D. Horning, Jr., a member of the Bar of this Court and one of the attorneys for petitioner herein, Union Oil Company of California, do hereby certify that, pursuant to Rule 33 of the Court on the 22nd day of July, 1958, I served a copy of the foregoing and annexed Petition for writ of certiorari to the United States Court of Appeals for the Fifth Circuit and Appendix thereto upon the Solicitor General, Department of Justice, Washington 25, D. C., upon Willard Gatchell, Esquire, General Counsel, Howard E. Wahrenbrock, Solicitor, W. Russell Gorman, Assistant General Counsel and Louis C. Kaplan, Attorney for respondent Federal Power Commission, attorneys of record for said respondent who represented it in the Court below, at their post office address of 441 G Street N.W., Washington 25, D. C. by depositing the same in the United States mail with first class postage prepaid addressed to each of the above-named persons at his above post office address.

/s/ GEORGE D. HORNING, JR.

APPENDIX

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 16581

BEL OIL CORPORATION, *Petitioner*,

v.

FEDERAL POWER COMMISSION, *Respondent*.

No. 16583

UNION OIL COMPANY OF CALIFORNIA, and THE LOUISIANA LAND AND EXPLORATION COMPANY, *Petitioners*,

v.

FEDERAL POWER COMMISSION, *Respondent*.

No. 16584

MORRIS RAUCH, ET AL., *Petitioners*,

v.

FEDERAL POWER COMMISSION, *Respondent*.

Petitions to Review Orders of the Federal Power Commission.

(April 23, 1958.)

Before TUTTLE, JONES and WISDOM, Circuit Judges.

TUTTLE, Circuit Judge: These petitions, presented on a single record, seek review of an order of the Federal Power Commission, Opinion No. 300, reported at 16 F.P.C. 100-118, dismissing certain rate filings of the petitioners as independent producer natural gas companies.[1] The rate

[1] In view of the holding by this Court in Deep South Oil Co. v. F.P.C., 5 Cir., 247 F. 2d 882; Shell Oil Co. v. F.P.C., 247 F. 2d 900, cert. den. 355 U.S. 930; Humble Oil & Refining Co. v. F.P.C., 5 Cir., 247 F. 2d 903, cert. den. 355 U.S. 930; and Continental Oil Co. v. F.P.C., 5 Cir. 247 F. 2d 904, we do not give further consideration to the contention that these are not natural gas companies within the purview of the Natural Gas Act, 15 U.S.C.A. 717.

increases would have been from 8.79 cents to 16 cents per Mcf, plus a 1 cent state tax.

On June 9, 1954, the three parties all had contracts with Transcontinental Gas Pipe Line Corporation (Transco), under which they agreed to furnish certain minimum quantities of gas for a period of twenty years, for which the price was fixed "temporarily" at 8.7915 cents per Mcf until November 1, 1954, and 16 cents per Mcf thereafter, with an automatic escalation of one cent every five years. It was on June 7, 1954, that the Supreme Court decided *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672. The Commission subsequently, by Orders 174, 174A and 174B permitted all independent natural gas companies engaged on or since June 7th in jurisdictional sales to file their rates in effect on that date without any supporting data to justify any increases that had theretofore been put into effect. The companies were permittd to file copies of their contracts in lieu of detailed rate schedules.

Petitioners filed their contracts, all of which provided for an automatic increase, on November 1, 1954. Two of the petitioners also filed notice of the increase to 16 cents. The Commission thereupon ordered all of these increases suspended under the authority of Section 4(e) of the Act. After the period of suspension the rates were permitted to go into effect under the terms of the Act which require reimbursement by petitioners if they should not ultimately be entitled to the rate charged.

A number of local distributing companies and state commissions intervened to oppose the rate increase and Transco intervened on behalf of the petitioners.

After several postponements, urged by petitioners, extended hearings were held. In general it can be stated that the evidence offered by petitioners consisted of proof of the competitive conditions in the Louisiana fields, the contracts negotiated by petitioners and others in that field, and evidence that the contracts were negotiated at arm's

length. After the presentation was concluded, without any cross examination or counter proof by interveners, a motion was made to dismiss on the ground that applicants had not sustained their burden of proof that the higher rate was "just and reasonable."

The Commission entered its "Order Postponing Action on Motion to Dismiss and Referring Proceedings to Examiner" in which it said:

> "... The fact that contracts have been entered into in good faith and in arm's-length bargaining does not make them immune from the regulation in the public interest prescribed by Congress, nor are producer contract terms per se an indication that the prices agreed upon are just and reasonable either initially or as subsequently increased pursuant to escalation clauses or otherwise. (See Colorado Interstate Gas Co. v. F.P.C., 142 F. 2d 943, 953 (C.A. 10, 1944), aff. 342 U.S. 581; Mississippi River Fuel Corp. v. F.P.C., 121 F. 2d 159, 163 (C.A. 8, 1941).)
>
> "The exhibit submitted by applicants to show relative field prices is merely a numerical listing of contract prices for gas sold within the pricing area and is insufficient to justify the proposed increases.
>
> "It may be observed that in providing for Commission responsibility in connection with rate filings the Natural Gas Act makes no distinction between independent producers and interstate pipeline companies. If they are subject to the Act, the same criteria and procedures are prescribed for rate-fixing purposes, since both classes are natural gas companies under the Act. The Commission is free, within the ambit of its statutory authority in rate fixing, to make the pragmatic adjustments which may be called for by particular circumstances (F.P.C. v. Natural Gas Pipeline Co., 315 U.S. 575, 586). While it is true that the source of our authority over rates of independent producers is contained in Sections (4) and (5) of the Natural Gas Act, we do not say that in fixing the rates of natural gas companies which are independent producers we are compelled to apply the same formula as that ap-

plied in fixing the rates of natural gas companies which are interstate pipeline companies.

"In dealing with the rates of interstate pipeline companies, we have pointed to the burden placed by Section 4(e) of the Act upon those natural gas companies seeking approval for rate increases and in appropriated cases have pointed to the failing of some companies to present evidence which would justify the increases, for which reason we have denied applications for approval, and in these actions we have judicial approval. (Mississippi River Fuel Corp. v. F.P.C., 121 F. 2d 159, 165 (C.A. 8, 1941).) The independent producers which are applicants herein are under the same burden as interstate pipeline companies to justify any proposed rate increases, even if their operations may differ.

"Upon consideration of all of these matters and the evidence so far presented, we would be required to grant the motion to dismiss and to terminate these proceedings, for the evidence does not show that the requested increased rates would be just and reasonable. Nevertheless, solely because this is the first series of cases involving the rates of independent producers upon which we have acted, we will allow Applicants a further period of time beyond which we do not propose to extend the resumption of the hearing, rather than granting the motion to dismiss forthwith.

. . . .

"The Applicants should now be fully prepared to demonstrate the lawfulness of the proposed increases or we must deny the applications and dismiss the proceedings. Reasonable consideration of the rights of the other parties and of the general public will justify no further delays."

Upon the reconvened hearing petitioners introduced additional evidence tending to show that petitioners did not possess any dominating position in the industry, that natural gas is competitive with other non-regulated fuels, that the proposed prices were comparable with unregulated prices for local consumption; that maintenance of such a

price is necessary to provide appropriate incentives for exploration and production of nautral gas in Louisiana. No evidence was offered to show the actual cost of service to the producers—that is no evidence as to any economic factors related to their financial interests or needs, none as to operating expenses or capital costs, as to the return or profits they were earning under the 8.79 cent rate or which they would earn under the 16 cent rate, no evidence to indicate whether the rate was necessary to maintain credit and to attract capital. It can fairly be assumed, we think, that the failure to adduce such evidence was part of petitioners trial strategy to make more persuasive their argument in favor of a field price basis, for rate purposes, for in the brief of Union Oil is the following statement:

> "It was the judgment of petitioners that evidence of that type would have led to confusion in the presentation of their case and prejudiced the chances of acceptance by the Commission of the principles which petitioners urged on the commission as the proper basis of regulation."

Because of the absence of the financial type of evidence, a motion was again made for a dismissal of the application. The Commission referred the case back to the Examiner to make his report, the record was opened for cross examination by interveners, which they waived, and thereafter the Examiner filed his report recommending dismissal because of the failure of petitioners to make out a prima facie case of reasonableness. The Commission, two members dissenting, held that there was a failure to make out a prima facie case of just and reasonable rate and granted the motion to dismiss. The Commission, for the first time, gave a strong indication of what it considered to be essential in the proof of just and reasonable rates. It said:

> "We think the recent decision of the Court of Appeals for the District of Columbia circuit, in City of Detroit v. Federal Power Commission, 230 F. 2d 810, cert. den. 352 U.S. 829, is controlling here."

That part of the City of Detroit decision germane to the Commission's discussion is:

> "For, though we hold that method [the rate base or cost of service method] not to be the only one available under the statute, it is essential in such a case as this, that it be used as a basis of comparison. It has been repeatedly used by the Commission, and repeatedly approved by the courts, as a means of arriving at lawful—'just and reasonable' rates under the Act. Unless it is continued to be used at least as a point of departure, the whole experience under the Act is discarded and no anchor, as it were, is available by which to hold the terms 'just and reasonable' to some recognizable meaning."

Following the order of dismissal, petitioners filed motions for rehearing and asked that the matter be referred once again to the examiner to permit petitioners to tender evidence of cost of service. The motions were denied.

Petitioners strongly contend that they urged the field price, or cost of commodity, evidence as adequate to support a finding of a just and reasonable rate in the best of faith, relying in great part, so they say, on representations to that effect by the Commission itself. They say the Commission in the Panhandle Eastern Pipe Line Co. case, Opinion No. 269, which is the case later reversed by the Court of Appeals for the District of Columbia Circuit, quoted from above sub nom. *City of Detroit v. Federal Power Commission*, valued the natural gas produced by an interstate pipe line company for rate making purposes on the basis of fair field price rather than on the basis of a calculated rate of return on the company's investment in its producing properties. They say that in applying to the Supreme Court for certiorari in the City of Detroit case, the Commission still stood on the field price theory of rate making. They also point out that the Commission, in its 1956 Report to Congress,[2] recommended an amendment to the Natural Gas Act as follows:

[2] 1956 Annual Report of the Federal Power Commission, p. 19.

> "A standard for pricing or evaluating natural gas as a commodity which would not require use of a rate base or traditional utility ratemaking principles, but which would enable the Commission to weigh the interests of the consumer in low prices with the necessity of providing assurance of future gas supplies;"

Petitioners argue from this record and in light of these circumstances, together with the broad scope which the Supreme Court says resides in the Commission in its ascertainment of a just and reasonable rate, first that the evidence was sufficient to establish a prima facie case, and second, if not, if excused their failure to offer the cost of service evidence at the two hearings and the case should be remanded to the Commission to permit them to do so.

In support of the first position, petitioners cite *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U.S. 591:

> "Congress, however, has provided no formula by which the 'just and reasonable' rate is to be determined. 320 U.S. 591, 600.

The Court also said:

> "We held in Federal Power Commission v. Natural Gas Pipeline Co., supra, that the Commission was not bound to the use of any single formula or combination of formula in determining rates. Its rate-making function, moreover, involves the making of 'pragmatic adjustments.' Id., p. 586. And when the Commission's order is challenged in the courts, the question is whether that order 'viewed in its entirety' meets the requirements of the Act. Id., p. 586. Under the statutory standard of 'just and reasonable' it is the result reached not the method employed which is controlling. Cf. Los Angeles Gas & Electric Corp. v. Railroad Commission, 289 U.S. 287, 304-305, 314; West Ohio Gas Co. v. Public Utilities Commission (No. 1), 294 U.S. 63, 70; West v. Chesapeake & Potomac Tel. Co., 295 U.S. 662, 692-693 (dissenting opinion). It is not theory but the impact of the rate order which counts. If the total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry under the Act is at an end." 320 U.S. 591, 602.

See also in this connection, *Federal Power Commission* v. *Natural Gas Pipeline Co.*, 315 U.S. 575, 586, and *Colorado Interstate Gas Co.* v. *Federal Power Commission*, 324 U.S. 581.

We cannot agree that these cases are authority for the proposition that the evidence thus far adduced makes out a prima facie case of reasonableness of the contract price of 16 cents. We do not hold that evidence of field price is irrelevant. We do hold that evidence of unregulated prices in the field is not sufficient to warrant a finding by the Commission that a price comparable to them is just and reasonable within the intendment of the Natural Gas Act. Neither is evidence of the field price when coupled with the opinion of experts that the price must be high enough to provide an incentive for exploration and development of new sources of supply.

Our attention has been called to the opinion and order issued on April 4, 1958, in the matter of Pan American Petroleum Corp., et al, Opinion No. 310, in which the Commission has found just and reasonable an increased rate from 75 to 85 cents per Mcf for an Oklahoma field without requiring proof of cost of service. Without having the record of that case before us, it is apparent that the Commission has nevertheless withdrawn somewhat from the generality of its holding that a rate-base method must in all events be used at least as a point of departure. Recognizing, however, as we do that the rate increase there was an extremely modest one, we do not conclude from that order that the Commission intends to abandon its position taken as to the petitioners here. In fact the opinion seeks to distinguish these cases. Some of the points of distinction are not, we think, significant. Without deciding that the rate-base method is essential in every rate case, we agree that the Commission did not have sufficient evidence before it to approve these rates as just and reasonable.

Upon the second position taken by the petitioners, however, we conclude that the Commission erred in the particular circumstances of these proceedings in not reopening the hearings once again to permit the petitioners to introduce evidence of a rate base which in its written opinion, after the close of the hearing, the Commission said for the first time is an essential part of such an inquiry. We fully share the Commission's conclusion that petitioners were not unaware during the two years of pendency of the matter that evidences of cost of service might in the end be an important part of the proof they would have to make. The Commission takes the position that, with ample warning of the inadequacy of their proof, the failure of petitioners to come forward with such evidence amounted to a calculated gamble by them which they lost, and that they should not be entitled to another opportunity to make out their case. If indeed petitioners made such a gamble, it was an expensive one. If this order stands, the petitioners in this and other cases dealt with by the Court at this time, are required to account for to their customers a substantial sum of between seven and eight million dollars, all or part of which they may really be entitled to keep if their proof finally wins the approval of the Commission of a higher rate. In such circumstances some parties would be unjustly enriched and petitioners would be heavily penalized without reference to the real merits of the controversy.

The regulation of the prices at which thousands of "natural gas companies" may sell to the pipe line companies is a difficult one at its best. It is a field which in many respects requires new formulas to test what is just and reasonable. We think it would be an unjust penalty if we were to apply too strict a rule as to the reception of evidence in such a case. This is clearly demonstrated by order No. 310 in Pan American Petroleum Corporation referred to above. We think it quite clear that in light of that order the Commission might adopt some pragmatic

standard to apply to these cases as it did with Pan American, et al.

Holding as we do that the proof was insufficient but that reasonable opportunity should be given to petitioners to bring forth additional proof, we think that we need not notice many of the other contentions of petitioners at this time. We do, however, hold that in line with our previous cases cited in footnote 1, *supra*, these petitioners are "independent producers" and "natural gas companies" and their sales are subject to regulation under the Act.

We also conclude that even though the increases here in issue had been predetermined by contract before the Supreme Court's decision of the Phillips case and thus before the cut-off date of June 7, 1954, they are "rate changes" subject to Section 4(d) of the Act[3] and not an initial rate subject to changes under Section 5(a) of the Act. Section 5(a) places the burden on the Commission or other moving party to prove the initial rate unjust or unreasonable. We passed on a similar question in *Mississippi Power & Light Co. v. Memphis Natural Gas Company*, 5 Cir., 162 F. 2d 388, cert. den. 332 U.S. 770, where the contract had a "favored nation" clause in it under which the consumer company contended it was entitled to an automatic reduction in rate. We said there:

> "The 'favored nation' clause became inoperative after the passage of the Natural Gas Act. Section 4 therof provides: '. . . every natural-gas company

[3] "Rates and charges; Schedules; Suspension of New Rates. Sec. 4.

"(d) Unless the Commission otherwise orders, no change shall be made by any natural-gas company in any such rate, charge, classification, or service, or in any rule, regulations, or contract relating thereto, except after thirty days' notice to the Commission and to the public. Such notice shall be given by filing with the Commission and keeping open for public inspection new schedules stating plainly the change or changes to be made in the schedule or schedules then in force and the time when the change of changes will go into effect. The Commission, for good cause shown, may allow changes to take effect without requiring the thirty days' notice herein provided for by an order specifying the changes so to be made and the time when they shall take effect and the manner in which they shall be filed and published."
15 U.S.C.A. §717(c)(d).

> shall file with the Commission . . . schedules showing all rates and charges for any transportation or sale . . . .' and 'no change shall be made by any natural-gas company in any such rate. . . except after thirty days' notice to the Commission and to the public . . . '.
>
> "Rate making is a legislative function that the courts will not interfere with, at least until the Commission has exercised the function. To give effect to the 'favored nation' clause would operate to transfer the legislative function of rate-making from the Commission to the courts."

See also *Cities Service Gas Producing Co.* v. *Federal Power Commission*, 10 Cir., 233 F. 2d 726.

What we have said with respect to the new rate being a change within contemplation of the Act also answers the complaint by petitioners that the Series 174 orders of the Commission are invalid as applied to them in view of the fact that they had already contracted for the increases prior to June 7, 1954. As pointed out in *Cities Service Gas Producing Co.* v. *Federal Power Commission, supra*, the Act itself forbids any changes in rates except under the terms of the Act. So far as is here relevant, all the 174 orders do is to implement this provision of the statute.

Other contentions of petitioners whose resolution is not implicit in the decision we now make, are not now passed upon but will await the completion of the record before the Commission.

The petition is granted to the extent that the Commission is directed to reopen these proceedings to afford petitioners reasonable opportunity to adduce such evidence as they may be advised is relevant to the inquiry whether the proposed rate of 16 cents plus 1 cent state tax is just and reasonable. In all other respects the petition is

DENIED.

Extract from the Minutes of April 23, 1958

No. 16583

UNION OIL COMPANY OF CALIFORNIA and THE LOUISIANA LAND AND EXPLORATION COMPANY,

versus

FEDERAL POWER COMMISSION.

Judgment

This cause came on to be heard on the petition of Union Oil Company of California and The Louisiana Land and Exploration Company for a review of an order of the Federal Power Commission issued on December 6, 1956 in Docket Nos. G-4331 and G-4332, and was argued by counsel;

On consideration whereof, It is now here ordered, adjudged and decreed by this Court that the petition for review in this cause be, and the same is hereby, granted to the extent that the Commission is directed to reopen these proceedings to afford petitioners reasonable opportunity to adduce such evidence as they may be advised is relevant to the inquiry whether the proposed rate of 16 cents plus 1 cent state tax is just and reasonable; and in all other respects that said petition be, and it is hereby, denied.

U. S. Constitution Provision Involved

U. S. CONSTITUTION, FIFTH AMENDMENT

"No person shall be . . . deprived of . . . property without due process of law."

Statutes Involved

PERTINENT PROVISIONS OF THE FEDERAL GAS ACT

The pertinent provisions of the Federal Gas Act, 52 Stat. 821, as amended, 15 U.S.C. Section 717, *et seq.* are the following:

SECTION 4. * * *

(d) Unless the Commission otherwise orders, no change shall be made by any natural-gas company in any such rate, charge, classification, or service, or in any rule, regulations, or contract relating thereto, except after thirty days' notice to the Commission and to the public. Such notice shall be given by filing with the Commission and keeping open for public inspection new schedules stating plainly the change or changes to be made in the schedule or schedules then in force and the time when the change or changes will go into effect. The Commission, for good cause shown, may allow changes to take effect without requiring the thirty days' notice herein provided for by an order specifying the changes so to be made and the time when they shall take effect and the manner in which they shall be filed and published.

(e) Whenever any such new schedule is filed the Commission shall have authority, either upon complaint of any State, municipality, or State commission, or upon its own initiative without complaint, at once, and if it so orders, without answer or formal pleading by the natural-gas company, but upon reasonable notice, to enter upon a hearing concerning the lawfulness of such rate, charge, classification, or service; and, pending such hearing and the decision thereon, the Commission, upon filing with such schedules and delivering to the natural-gas company affected thereby a statement in writing of its reasons for such suspension, may suspend the operation of such schedule and defer the use of such rate, charge, classification, or service, but not for a longer period than five months beyond the time when it would otherwise go into effect: *Provided*, That the Commission shall not have authority to suspend the rate, charge, classification, or service for the sale of natural gas for resale for industrial use only; and after full hearings, either completed before or after the rate, charge, classification, or service goes into effect, the Commission may make such orders with reference thereto as would be proper in a proceeding initiated after it had become effective. If the proceeding has not been concluded and an order made at the expiration of the

suspension period, on motion of the natural-gas company making the filing, the proposed change of rate, charge, classification, or service shall go into effect. Where increased rates or charges are thus made effective, the Commission may, by order, require the natural-gas company to furnish a bond, to be approved by the Commission, to refund any amounts ordered by the Commission, to keep accurate accounts in detail of all amounts received by reason of such increase, specifying by whom and in whose behalf such amounts were paid, and, upon completion of the hearing and decision, to order such natural-gas company to refund, with interest, the portion of such increased rates or charges by its decision found not justified. At any hearing involving a rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the natural-gas company, and the Commission shall give to the hearing and decision of such questions preference over other questions pending before it and decide the same as speedily as possible. [52 Stat. 822 (1938); 15 U. S. C. § 717c]

* * * * *

SEC. 5. (a) Whenever the Commission, after a hearing had upon its own motion or upon complaint of any State, municipality, State commission, or gas distributing company, shall find that any rate, charge, or classification demanded, observed, charged, or collected by any natural-gas company in connection with any transportation or sale of natural gas, subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order: *Provided, however*, That the Commission shall have no power to order any increase in any rate contained in the currently effective schedule of such natural-gas company on file with the Commission, unless such increase is in accordance with a new schedule filed by such natural-gas company; but the Commission may order a decrease where

existing rates are unjust, unduly discriminatory, preferential, otherwise unlawful, or are not the lowest reasonable rates.

* * * * * *

SEC. 19. * * *

(b) Any party to a proceeding under this Act aggrieved by an order issued by the Commission in such proceeding may obtain a review of such order in the circuit court of appeals of the United States for any circuit wherein the natural-gas company to which the order relates is located or has its principal place of business, or in the United States Court of Appeals for the District of Columbia, by filing in such court, within sixty days after the order of the Commission upon the application for rehearing, a written petition praying that the order of the Commission be modified or set aside in whole or in part. A copy of such petition shall forthwith be served upon any member of the Commission and thereupon the Commission shall certify and file with the court a transcript of the record upon which the order complained of was entered. Upon the filing of such transcript such court shall have exclusive jurisdiction to affirm, modify, or set aside such order in whole or in part. No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission in the application for rehearing unless there is reasonable ground for failure so to do. The finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. If any party shall apply to the court for leave to adduce additional evidence, and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the proceedings before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The Commission may modify its findings as to the facts by reason of the additional evidence so taken, and it shall file with the court such modified or new findings, which

if supported by substantial evidence, shall be conclusive, and its recommendation, if any, for the modification or setting aside of the original order. The judgment and decree of the court, affirming, modifying, or setting aside, in whole or in part, any such order of the Commission, shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification as provided in sections 239 and 240 of the Judicial Code, as amended (U. S. C., title 28, secs. 346 and 347).

* * * * *

UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Before Commissioners: Jerome K. Kuykendall, Chairman; Seaborn L. Digby, Frederick Stueck, William R. Connole and Arthur Kline.

In the Matters of

Pan American Petroleum Corporation[1]	Docket No. G-8624
Sohio Petroleum Company	Docket No. G-8624
Continental Oil Company	Docket No. G-8625
Skelly Oil Company	Docket No. G-8626
British-American Oil Production Company	Docket No. G-8627
The Carter Oil Company	Docket No. G-8628
Gulf Oil Corporation	Docket No. G-8629
The Atlantic Refining Company	Docket No. G-8631
Anderson-Prichard Oil Corporation	Docket No. G-8632
West Edmond Oil Company	Docket No. G-8635
Sunray Mid-Continental Oil Company	Docket No. G-8637
Sunray Mid-Continental Oil Company	Docket No. G-8638

Opinion No. 310

OPINION AND ORDER APPROVING RATES

(Issued April 4, 1958)

These proceedings arose upon the filing by the several independent producers in the above entitlement of in

[1] Formerly Stanolind Oil and Gas Company.

creased rates for the sale of natural gas to Cities Service Gas Company from the West Edmond Field in the State of Oklahoma. The rates filed by the companies have been increased from 7.5 cents per Mcf to 8.5 cents per Mcf at 16.4 psia,[2] and have been suspended by the Commission under Section 4(e) of the Natural Gas Act. With one exception,[3] they were allowed to become effective in May, 1955, under corporate undertakings to make refunds. . . .

Before the hearing Pan American Petroleum Corporation separately, and Sohio Petroleum Company and Continental Oil Company, jointly on behalf of all other rate proponents, filed motions to terminate the proceedings, challenging the jurisdiction of the Commission to suspend the increased rates. By order of June 4, 1956, 15 F.P.C. 1488, the Commission denied both these motions finding that it possessed power and jurisdiction to determine the lawfulness of the increased rates filed. At the hearing, held June 4 and 5, and July 9, 1956, the only evidence presented, except for rate schedules, was that offered jointly by Sohio and Continental, but the other parties stated through counsel that they were relying on such evidence. The presiding examiner in his decision issued January 8, 1957, granted a motion by staff counsel made at the hearing to disallow the increased rates and dismiss the proceedings on the ground that the proponents had not sustained their burden of proof under Section 4 of the Natural Gas Act that the increased rates were just and reasonable.

All parties to the proceedings except the staff filed exceptions to the presiding examiner's decision, either in

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[2] These prices became 6.7 cents and 7.6 cents per Mcf when adjusted to the Oklahoma standard of 14.65 psia. The prices should be further adjusted to conform to deviations from Boyle's Law, the latter price becoming 7.3 cents per Mcf, excluding .3 cents for reimbursement of the Oklahoma tax.

[3] The Atlantic Refining Company did not request that its increased rates become effective after suspension.

full or by joining in the exceptions of other parties. The exceptions include contentions that the periodic rate increase was not suspendible under Section 4 of the Natural Gas Act, that the increased rate was just and reasonable, and that the rate-base method was not properly applicable to independent producers. All parties except the West Edmond Oil Company and the staff made motions for oral argument or joined in the motions of other parties. . . .

It appears from the record that there is no affiliation between Sohio, the unit operator, and the buyer of the gas, Cities Service, and there is nothing in the record to show that there is any affiliation between any of the other rate proponents and Cities Service. The record indicates that the negotiations leading to the 1951 amendment of the contract with Cities Service were conducted at arm's length.

In addition to the testimony concerning the West Edmond Field, the Unit, and the contractual arrangements between the parties, Sohio and Continental presented the testimony of a consulting economist. The economist discussed the general problems arising in the regulation of the independent producers. He pointed out particularly the difficulties in attempting to regulate by means of the cost of service method, which he said, among other things, would result in a diversion of the interstate supply of natural gas to the intrastate market. He concluded that the competitive price or commodity value standard was the appropriate basis of regulation.

Evidence was also presented as to the prices at which natural gas has sold since 1945 in the State of Oklahoma. This evidence showed that in the four counties in which the Unit is located and in seven adjacent counties, with few exceptions, prices as of April 1, 1956, were 10 cents per Mcf at 14.65 psia. Furthermore, in the entire State of Oklahoma in 1954 the price of 10 cents per Mcf was fixed by one half of the contracts, and the average was

9.80 cents. In the year 1955 Cities Service paid 9.12 cents per Mcf at 14.65 psia at gasoline plants in Oklahoma, an average of 9.96 cents from all sources in Oklahoma, and an average price for all field and gasoline plant purchases of 10.14 cents per Mcf. In this connection it may be noted that another witness representing Continental Oil Company testified that the prevailing or going price in Oklahoma for sales comparable to those involved in these proceedings ranged from 10 cents to 13½ cents pre Mcf at 14.65 psia. The evidence further shows that a portion of the gas produced from the West Edmond Field and processed in part in the Edmond Plant is sold intrastate to Oklahoma Natural Gas Company under a 1954 contract with Phillips and Continental providing for a price of 10 cents per Mcf at 14.65 psia until December, 1957, and a price after that date of 11 cents per Mcf.

On the basis of this record the presiding examiner reached his conclusion that the rate proponents had not sustained their burden of proof under Section 4 of the Natural Gas Act. The presiding examiner took as controlling our decision in the *Union Oil* case, 16 F.P.C. 100, rendered on December 6, 1956, in which we found that evidence of arm's-length bargaining and of market value of the gas sold, without evidence that the increased rates were no higher than necessary to encourage exploration and production, was not sufficient to prove the justness and reasonableness or the increased rates.[4] It is apparent that the presiding examiner felt there was insufficient evidence of cost or of the revenue requirements of the rate proponents to take this case out of the rule laid down by us in the *Union Oil* case. Upon examining this record and considering the various types of cost evidence and what evidence of cost the rate proponents might

[4] We have also found that evidence under the rate-base method was requisite for the same purpose in the cases involved. *Sears, Herrmann Corp.*, 18 F.P.C. 244; *Delhi Taylor Oil Corp., et al.*, 18 F.P.C. 375, 378.

reasonably have been expected to produce in this case, we find that we differ with the presiding examiner's conclusion, for we are of the opinion that the rate proponents have done all that could be expected of them and all this necessary in showing that their proposed rate is just and reasonable.

The present case presents a different factual situation than other independent producer rate cases previously considered by us. It demonstrates clearly the inappropriateness of utilizing the rate base formula in fixing producer rates, and that the use of such a formula produces incongruous results and in the long run is detrimental to the interests of consumers who need supplies of natural gas on a long-term basis. Accordingly, we give here the reasons for our action in these proceedings somewhat at length because we regard this as an opportunity to state a factual situation typical of many other proceedings. At the same time, the facts in this situation are distinguishable from cases previously decided, some of which are now undergoing judicial review.

In the first place it seems clear that the traditional rate base method cannot be used in a case of this kind. It is impractical and not conducive to effective regulatory results to use the rate base method in a case involving eleven independent producers operating in one field where only a small portion of the rates of each company is being investigated. In the past we have almost invariably employed the rate base method for rate cases under the Federal Power Act and for pipeline rate cases under the Natural Gas Act, but ordinarily only one or a very small number of companies has been involved and usually all of the jurisdictional rates have been before the Commission. One reason for this is that the rate base method requires a study of the entire operations of each company

[5] However see *Panhandle Eastern Pipeline Company*, 13 F.P.C. ..., Op. No. 269, Docket No. G-1116, April 15, 1954, reversed as *City of Detroit* v. *F.P.C.*, 230 F. 2d 810 (CADC), certiorari denied, 352 U.S. 829.

regardless of whether all or only part of the company's rates are being fixed. This is because there must be allocated to the jurisdictional sales not only the facilities and expenses directly involved, but also a portion of the administrative and general expenses of the whole company, and in determining a proper rate of return there must be considered the cost of money, that is debt capital and equity, to the whole company. Furthermore, with respect to a natural gas producing company, the exploration and development program of the company as a whole would have to be examined in order to determine the costs of this program allocable to the jurisdictional sales involved, a result of the necessity of examing the operations of the company as a whole, a rate case, which employs the rate base method, is usually a long drawn-out affair.

In this case ten of the eleven rate proponents, West Edmond Oil Company being excepted, are engaged in extensive production operations throughout the country, so that these proceedings represent only a fragmentary portion of the operations of any one company. There was no reason here to examine all of the jurisdictional rates of each of these producers. To require rate base evidence in a case of this kind would necessitate, as indicated above, a complete examination of their entire plant and operations in order to regulate only a fraction of their sales. Such a procedure would involve an extensive taking of evidence that would delay the fixing of rates for years to the public dertiment and would be a wholly infeasible administrative procedure.

We are also concerned with the results that would be produced by the use of the rate base method. To paraphrase Justice Jackson in his concurring opinion in *Colorado Interstate* v. *F.P.C.*, 324 U.S. 581, 610,[6] these

[6] The *Colorado Interstate* case upheld the Commission in applying the rate base method to the producing properties of a pipeline company. See also Justice Jackson's dissent in *F.P.C.* v. *Hope Gas Co.*, 320 U.S. 591, 649.

results would be "delirious" and "capricious" if applied to the operations of the producers involved here. In this proceeding there are eleven different rate bases, 133 in the entire field, and the record indicates that these rate bases bear no reliable relationship to the amount of oil and gas produced.

The largest items in the rate base of a producer are the cost of acquisition of the leases, the cost of geophysical work and the cost of drilling and equipping wells. The record discloses that the cost of drilling wells to the Hunton Lime Formation was reasonably uniform, usually within 20% one way or the other of $90,000. No such uniformity existed with respect to the acquisition cost of the various leases in this field. Some were acquired at a much higher price than others. Some were "burdened" by interests reserved by prior owners or leaseholders, such as over riding royalties, working interests or interests arising under "farm-outs" or other agreements.[7] While purchasers of gas leases will not pay high prices without the expectation of production, until a well is actually drilled, there is no way of telling how much, if any, or gas will be produced.

As noted already each of the 754 tracts included in the unit have been given a different percentage participation in the production from the field. In fact some tracts receive 27 times as much as other tracts.[8] If two such owners happened to pay the same amounts for their leases, one would need to receive 27 times as much per Mcf for his gas as the other owner in order to obtain the same return on

[7] Frequently in the development of a gas field relatively small amounts are paid for the initial leases acquired which often are the best producing leases, while as the field is developed much higher amounts may be paid for adjacent leases that produce little or no gas.

[8] For example, the Sohio well on tract 439 receives .01076 of the entire production; the Fox Oil Company well on tract 425 receives .01109, the Champlin Oil Company well on tract 615 receives .01144 while the Harris well on tract 246 receives .2988 and the Sohio well on tract 228 receives .2957.

its investment. The result is that if the traditional rate base method were employed there would result 133 widely varying prices for gas produced from one formation in one field.[9] Obviously this result is not in the public interest particularly since some of the high priced gas would not be competitive with other gas or other fuels and could not be sold.

As noted above a portion of the gas from the Edmond plant has been sold intrastate to Oklahoma Natural Gas Company for 10 cents per Mcf until December 1957 and 11 cents thereafter. An obvious and ultimate result of application of the cost rate base method to individual producers will be to drive the low-cost gas to the intrastate markets where it can be sold for the field price, and leave only the high-cost gas for the interstate market.[10] Such a result would be contrary to the interest of that portion of the public dependent upon the interstate sale and transportation of gas—the very public interest which it is our duty to protect.

It should be observed we are not in this case disapproving the use of the rate base method in all producer cases. As we held in effect in *Union Oil*, the Natural Gas Act makes no differentiation between regulation of the production of gas by pipelines and by independent producers, and

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[9] Although there are 133 separate lessees in the unit, the numerous owners of royalties and working interests are entitled to receive payment in kind and would undoubtedly do so if it were to their financial advantage. Accordingly, there might very well be several hundred, rather than 133, different prices in this one horizon in this one field.

[10] This very record discloses that the 1954 contract between Oklahoma Natural and Phillips and Continental for the intrastate sale of gas from the Edmond Plant contains a provision that at the expiration of the contract with Cities Service on March 31, 1957, the gas involved here would be sold to Oklahoma Natural under the provisions of the 1954 intrastate contract providing for a price of ten cents per Mcf until December 1957 and of eleven cents thereafter unless the sellers were prohibited by the regulatory authority having jurisdiction.

the *City of Detroit* case[11] would indicate that we must use this method as a point of departure in a proper case. We are, in fact, proceeding in a number of cases to attempt to apply this method to individual producers. The complexity of the problems which have arisen in these cases has been such that although several of the cases have been in progress for nearly three years, although the Commission has been using every means available to expedite them, and although the staff and parties have been at all times diligent in prosecuting them, not a single proceeding has yet been submitted to a presiding examiner for his final decision. When we consider the large number of producers coming under our jurisdiction, the fact that their costs, unlike those of pipeline companies which have a large fixed investment, are highly variable from year to year, thus necessitating almost continual revision of their rates,[12] in order not to permit on the one hand a rate of return which is too high or on the other hand such a low rate of return as will result in confiscation, it is apparent that we are

[11] *City of Detroit* v. *F.P.C.*, 203 F. 2d 810 (CADC), certiorari denied, 352 U.S. 829.

[12] An illustration of the need for continual revision of a producer's rates if the rate base method is used is afforded by the evidence in this case. The original estimate of the reserves of the Hunton Lime Formation of the West Edmond Field was made in 1944. It was then estimated that the ultimate recovery would total 200 million barrels of oil and 500 million Mcf of gas. An estimate made in 1946 showed an estimated ultimate total recovery of 140 million barrels of oil and 559 million Mcf of gas. The most recent estimate concerning which there was testimony was made in 1953 and showed an ultimate total recovery of 100 million barrels of oil and 819 million Mcf of gas. Each new estimate of the ultimate recoverable reserves of gas directly affects the cost of the gas on a unit basis and requires a new determination as to the unit price of the gas if the rate base method is used. This is true also of any change in the oil reserve estimate even though there is no change in the estimate of gas reserves since such a change necessitates a change in the allocation of the costs between oil and gas and would thus directly affect the unit price of the gas. The amount of available gas reserves at any given time is but one of the many unstable or constantly changing conditions which occur in the business of producing gas which necessitate changes in the unit cost and hence in the unit price at which the gas must be sold if the rate-base method is used.

confronted with an almost hopeless administrative task. These attempts to use this method have resulted in great expense which ultimately must be borne by the consuming public, have caused great confusion in the industry, have led to the withholding of some gas from the interstate market a probable result of which has been in increased prices for the remaining supply, and have led to many other results detrimental to the public interest. All of these results were testified to or forecast by Dr. J. Rhodes Foster, a witness in this case. We believe that we must under the *City of Detroit* decision continue in a proper case to attempt to apply the rate base method. Nonetheless, we feel we would be remiss in our duty if we fail to point out to the Congress and the Courts at every opportunity, that these attempts impose a most difficult administrative burden, and in our opinion are contrary to the public interest, and are causing grave injury to the consuming public. It has been urged that we should wait until cases using the rate base method are before us before deciding these issues. However, this will be many months, possibly years, from now and every day of delay in making our position clear is resulting in injury, both to the industry and to the consuming public; accordingly, we must apprize the situation as it exists now and either reaffirm or alter our views after actual independent producer rate base cases have been considered by us.

Even though it is impossible under the facts of this case, to employ the traditional rate base method we should consider whether cost evidence could be adduced on a field or area basis. In our opinion the rate proponents could not reasonably have been expected to produce cost evidence for either the West Edmond Field or any other area. To obtain cost evidence for the West Edmond Field would require data on the operating expenses, plant and fair rate of return for every producer in the field. Such evidence is not available in this record and could not be obtained without extending the proceeding to each one of the 133

lessees, although there might be no reason to regulate their rates. As it is, only eleven of these lessees are before us, representing 46% of the production of the Hunton Lime. Obviously they cannot give complete data as to the field, so that alone is sufficient cause for their not producing field evidence.

The administrative problem is in any case insuperable. It would be necessary to go into each producer's books not only to obtain data on certain operating expenses,[13] plant and what would be a fair rate of return, but also to determine what would be a necessary allowance for exploration and development. The necessary judgment with respect to each of these items, but particularly the last, would have to be multiplied many times over so as to render the task an extremely difficult one. Otherwise arbitrary figures unsupported by the record would have to be used.

Another complicating factor in attempting to obtain and utilize cost evidence for the field is that there are three other producing strata or horizons other than the Hunton Lime. Since some wells in this field obtain production from several of these horizons, it will be necessary to examine costs, production and prices of gas with respect to each of these horizons in order to determine costs allocable to the production from the Hunton Lime.

Similar difficulties would arise if we should attempt to determine costs on the basis of some other area larger than the West Edmond Field. All of the producers in the area would become necessary parties, and there would be even more of them than in the West Edmond Field.

Whether the West Edmond Field or some other area is used as a basis for assembling cost data and regulating

[13] Since this field is now being operated as a unit, actual field operating costs of all producers can be obtained from the unit operator, but it is necessary to go to each producer's books to determine such operating expenses as its income and other taxes, and administrative and general expenses.

rates, our statutory powers to fix rates in such a manner are uncertain in view of the *Mobile Gas* case.[14] In that case the Court stated that the Natural Gas Act does not provide a rate-making nor a rate-fixing procedure but simply the power to review rates and contracts made in the first instance by natural gas companies, and, if they are determined to be unlawful, to remedy them.

Even if we did not require strict cost evidence on an individual company basis or on a field or area basis, but would accept as sufficient evidence similar to that submitted in *United Carbon Company et al.*, 19 F.P.C. ....., Docket No. G-9572, February 19, 1958, the rate proponents here could not be reasonably expected to comply with such a standard. In the *United Carbon* case the two producers involved introduced evidence with respect to their producing operations to show various expenses and other payments to be made over a five-year period, including the costs of dry holes and productive wells, but without the computation of a rate base, depreciation and depletion. Without determining whether the evidence submitted was sufficient to support the proposed increased rates, we denied the staff's motion to dismiss.

In the present case the type of evidence introduced in the *United Carbon* case would create practical difficulties similar to those that would be created by adherence to the traditional rate base approach. Only a portion of the operations of the eleven rate proponents here occur in the West Edmond Field, and each one of the eleven rate proponents, or the 133 other lessees in this field would show diverse costs, resulting in eleven, or 133, different prices in the same field. The submission of such evidence, like that under the rate base method would be administratively unworkable. In addition, we have not finally approved this type of evidence. Further consideration of the *United*

[14] *United Gas Pipe Line Co. v. Mobile Gas Service Corp.*, 350 U.S. 332.

Carbon case may show that this type of evidence is not satisfactory or reliable.

These are the various methods which have been used or suggested to determine rates on a cost basis. Turning now to the evidence adduced in this case, we find that in addition to field price evidence there is evidence tending to show cost which, although neither the conventional type of cost evidence or any of the types discussed above, in our opinion is persuasive and serves in connection with the field price evidence to convince us that the rate proponents have made a prima facie case in support of the proposed rates. This evidence shows that 290 of the 750 producing wells in the unit have been abandoned and plugged, at least as to the Hunton Lime, because operating costs[15] alone, without regard to any return on the rate base, exceed the price for which gas and other petroleum products can be sold. Thus the cost of producing gas from these 290 wells exceeded the price 7½¢ per Mcf rate. Also there was testimony that unless the rate increase were allowed, additional wells would have to be abandoned. This is positive evidence that over one-third of the wells in the field are not yielding any return on their investment. It is also apparent that many more wells are not yielding any return on their investment since other operating costs including a reasonable amount to be allowed for exploration and development (which often amounts to 30% or more of the gross revenues) must also be charged against any given well before it can show a return on the investment.

The conclusion that operating costs are a very substantial item in the production of gas from this field can logically be drawn from this evidence. The Bureau of Labor Statistics has published figures showing that during the period covered by this contract, 1951 to 1956, there have been substantial increases in the wages of the different classes of labor engaged in operating gas fields and in the cost of

[15] We are here referring only to actual field operating costs.

materials and equipment used in the operation of gas fields. This evidence, while not proof in itself of the justness or reasonableness of the rates here involved, indicates that higher rates are needed in 1956 than in 1951.

There was also evidence that the addition to oil and gas reserves per thousand feet of exploratory well decreased approximately 50% from 1948 to 1955. While no cost figures were offered, assuming that other factors such as labor and material costs were constant, the amount needed for exploration and development would be double as much in 1955 as in 1948.

The evidence also showed changes in the purchasing power of money as measured by the wholesale price index, which demonstrated that between 1945 and 1956 the value of the dollar had declined 40%. The result of this was that the 5 cents per Mcf price in 1945 was equivalent in April, 1956, to 8.3 cents per Mcf, or, in other words, the 8.5 cents rate sought in 1956 was the equivalent of only 5.1 cents per Mcf in money of 1945 purchasing power. We mention this particular evidence only because it shows that costs of producing gas are increasing. Operating costs are a substantial item in the production of gas and this evidence tends to show some justification for an increase in price. No change in our treatment of original cost in determination of a rate base should be inferred from our reference to it.

The foregoing evidence, as supplemented by the field price evidence and by evidence that the proposed price was arrived at by arm's-length bargaining, might not be sufficient to sustain the burden of proof of producer rate proponents in many cases.[16] But here we are of the opinion that the methods of determining cost, including the traditional rate base method, discussed above and rejected by

[16] See *Union Oil Co.*, 16 F.P.C. 100; *Sun Oil Co.*, 17 F.P.C. 174; *Crow Drilling Co.*, 17 F.P.C. 226; *Associated Oil and Gas Company, Orange Grove Oil and Gas Corp.*, 17 F.P.C. 199; *Forest Oil Corp.*, 17 F.P.C. 586; *Sears, Herrmann Corporation*, 18 F.P.C. 244; *Delhi-Taylor Oil Corp.*, 18 F.P.C. 375.

us as inapplicable, cannot reasonably be used in this case, nor can we require evidence under these methods to be adduced by the rate proponents. Under these circumstances, we are of the opinion that the foregoing evidence relating in a general way to cost is persuasive and should be considered with the other evidence in this case.

Finally, considering all of the circumstances in this case including, *inter alia*, that the evidence shows this proposed price of 7.6¢ at 14.65 psia to be approximately 25% less than the generally prevailing field prices in this area at the time in question, that we have already approved on three separate occasions a 10¢ rate for sales of gas to Cities Service from fields in nearby counties,[17] in which cost evidence was submitted and considered by the Commission, ths fact that the proposed increase is very modest and that there is substantial evidence from which it can logically be concluded that the costs of operating a gas field and producing gas were increasing during the five-year period from 1951 to 1956 covered by this contract, and that we have been allowing higher rates to go into effect without suspension and with no more justification than has been shown here, we conclude that it would be grossly inequitable to deny the proposed increase in rates. We further conclude, in view of all of the circumstances we have related that the rate proponents have done all that could be expected of them to show that their rates are just and reasonable and that there is sufficient evidence in the record to justify a finding that the rates are just and reasonable.

In reaching our conclusions herein we are not unmindful of the *City of Detroit* case[18] where the Court held that in determining an allowance for gas used by a pipeline from

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[17] *Davidor & Davidor*, 15 F.P.C. 1236; *Christie, Mitchell and Mitchell*, 15 F.P.C. 751; *Wunderlich Development Co.*, 15 F.P.C. 690.

[18] *City of Detroit v. F.P.C.*, 230 F. 2d 810 (CADC), certiorari denied 325 U.S. 829.

its own reserve, the traditional rate-base method must be used as an "anchor" and "point of departure". The factual situation here is, of course, quite different and as we have shown, it is almost impossible administratively and contrary to the public interest to use the rate base method in a case involving the rates of eleven producers. In fact, while we have disallowed a number of proposed independent producer rate increases[19] where there has been a failure to submit rate-base evidence or evidence or requirements, and where we thought such evidence might have been produced; we have not determined in any case the extent to which such evidence should be required of the independent producers. It is clear as the Court said in *F.P.C.* v. *Natural Gas Pipeline Co.*, 315 U.S. 575, 586, that the Commission is not bound to any single formula of rate making.[20] Since our decision in *Union Oil*, the Court of Appeals of the District of Columbia, the same Court which decided *City of Detroit*, said in *Mississippi River Fuel Corp.* v. *F.P.C.*, F2d (CADC) with respect to the use of field prices in appraising the rates of an affiliated producer selling to a pipeline company, "A 100 per cent affiliate stands in the same position as does the integrated producing 'arm' of a pipe-line company", implying that a non-affiliated producer might stand in a different position, and while requiring the Commission to investigate a rate increase charged by the producer to its parent, added that it did not hold a "full blown" inquiry into the rates of the producer necessary.

Apart from these considerations applicable to all producers in this case we do have some evidence relating to cost and the three separate cases referred to above which, in part on the basis of cost evidence, support the rates here

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[19] See Footnote (16), *supra*.

[20] See also *F.P.C.* v. *Hope Gas Co.*, 320 U.S. 591, 602, where the Court said that "under the statutory standard of 'just and reasonable' it is the result reached not the method employed which is controlling."

proposed and provide an "anchor" not present in *City of Detroit*.

In the *City of Detroit* case, as is patent from reading the opinion, the Court was primarily concerned with the protection of the consumer of gas. It is clear here that to disallow this increased rate because of rigid adherence to a cost policy would not only discourage further exploration of the natural gas resources but would encourage the intrastate sale to Oklahoma Natural Gas Company to the detriment of the consumers elsewhere. To approve this rate, which we think fully supported, is a type of "pragmatic adjustment" which we are permitted to make. *F.P.C. v Natural Gas Pipeline Co.*, supra, p. 586. Cf. *Market Street Railway Co. v. Comm'n.*, 324 U.S. 548, 563-569.

Likewise, we believe that our opinion in the *Union Oil* case is distinguishable. The 1¢ increase here is hardly to be compared to the increase in excess of 7¢ (from 9.797¢ to 17¢ per Mcf) in that case. It is an increase of less than 15% as contrasted to an increase of 75% in *Union Oil*. The increase here was under the escalation provisions of a contract while the increase in *Union Oil* was pursuant to the terms of a new renegotiated contract. There was no evidence in *Union Oil* of any prices in the immediate area equal to or in excess of the rate proposed by *Union Oil* which had been found just and reasonable by the Commission, while here there are three such cases which we have cited above. Here there is some evidence of cost, although admittedly of a very general nature, while in *Union Oil* there was none. It is true that in *Union Oil* we said there must be evidence of revenue requirements, but we were careful to leave the door open for evidence of revenue requirements for the industry as a whole, revenue requirements for the industry in a particular area, or revenue requirements for the individual producer. Here as we have shown it is utterly impractical to require evidence of revenue requirements.

Finally we are confronted with the question of what disposition we should make of this case. It is obvious that if the case is remanded in its present posture, the staff will be faced with the same inability to present detailed cost evidence as the applicants, if the staff should decide to produce such evidence. Accordingly, we are faced with the following alternatives: (1) To deconsolidate these proceedings and try each of the eleven cases separately under the rate base method; (2) To broaden the scope of this hearing by combining these proceedings with rate proceedings against all other producers in the field or in a larger area such as the State of Oklahoma and setting a price for the entire field or area; (3) To remand the case for cross-examination of applicant's witnesses and the presentation by the staff of such evidence of field prices and other evidence as the staff deems proper; (4) To approve the proposed increased rates without further proceedings.

The first alternative would result in eleven different prices in the field, or 133 different prices if action is instituted against all producers in the field, and is administratively infeasible. The second alternative meets with insuperable procedural difficulties,[21] and there is doubt as to our authority to set rates in that type of proceeding under Sections 4 and 5 of the Natural Gas Act as construed in the *Mobile Gas* case.

The choice between the third and fourth alternatives is a more difficult one to make. However, we do not believe anything new or different can be presented in the way of field price evidence. Not only have we had before us the three cases cited above arising in this immediate area in which we determined 10c to be a reasonable field price, but we are continually appraising evidence of field prices in

[21] In addition to the difficulties we have mentioned, these proceedings are concerned with the rates to be charged beginning April 1, 1955. It is now too late to join other producers in this field or area whose rates we have not suspended and fix their rates for this past period of time.

various areas in order to determine whether or not to suspend.[22] We also had considerable evidence in the *Signal Oil* case[23] that the prevailing field price in this area of Oklahoma for both intrastate and interstate sales was 10¢. Accordingly, we feel on the basis of the many investigations and cases which we have had in this immediate area, in which the staff has submitted evidence of field prices substantially similar to that submitted by the rate proponents in this case that the evidence of field price now in the record bears great credibility. Neither do we feel for the reasons which we have discussed at length that further cost evidence which will be of a substantial benefit can be produced in these proceedings.

We have permitted numerous increases in this area to what we have felt was the prevailing field price of 10¢. In no other field in the State of Oklahoma have we suspended an increase of a proposed producer rate as low as 7.6¢ per Mcf at 14.65 psia. The suspension in this case can be explained by the fact that the original suspension occurred shortly after the *Phillips'* decision[24] when our data on field prices were incomplete and our experience on these matters was limited. For us now to require further proceedings would amount to undue discrimination on our part against these rate proponents.

One of the anomalies in the administration of the Natural Gas Act since the *City of Detroit* case is that while we are

[22] For example, in our meeting of December 19, 1957, we had before us 43 proposed increases in the State of Oklahoma, four of which were in Logan and Oklahoma Counties, the same counties in which the West Edmond Field is located. Forty-one of the increases were from 10¢ to 11¢, of which we suspended 40 and allowed the other, one from 10¢ to 20¢ which we suspended, and one, a two-part increase from 8¢ to 11¢ as to which we allowed the 2¢ portion making the effective rate 10¢ and suspended the remaining 1¢.

[23] *Cities Service Gas Co., Signal Oil and Gas Co.*, 14 F.P.C. ....., Op. No. 288, Docket Nos. G-2569, G-2570, November 28, 1955, affirmed as *Signal Oil and Gas Co.* v. *F.P.C.*, 238 F. 2d 771 (CA 3), certiorari denied 353 U.S. 923.

[24] *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672.

not permitted to use field prices alone in determining whether a price is just and reasonable after it has been suspended by us, no such standard is required of us in determining whether or not we should suspend in the first instance. It is, of course, administratively impossible, even with a staff many times as large as we now have, to investigate, even casually, the costs of every rate proponent who files a rate increase, and the principal guide we have used in determining whether or not to suspend has of necessity been a comparison of the proposed price with field prices in the area. The Natural Gas Act sets up no standards as to what the Commission shall consider in exercising its suspension powers, and the Commission has not traditionally gone into the question of costs at the suspension stage of the proceedings. For the Commission to use field prices as a standard in determining whether or not to suspend and then to be prohibited from using such prices in determining the justness and reasonableness of the rates is completely illogical and unreasonable.

Further, to remand this case rather than to approve the proposed rates will mean that these rates will be in an unsettled status for another year or two until the case is finally determined. As the rates were suspended in March, 1955, three years ago, a total delay of over four years in determining the rates of these independent producers will result. It is apparent that after a lapse of several years the ultimate consumer, who is several times removed from the producer, may receive little, if any, benefit from a reduction in prices paid the producer, but, instead a windfall may accrue to some pipeline or distributor along the way. While delay cannot be avoided in many cases, and in itself is no reason to dismiss rather than remand a case, the public interest in fixed and definite rates is a factor to be considered under such circumstances.

In view of our disposition of these matters there will be no necessity for oral argument.

The Commission finds:

. . . (3) The increased rates and charges, subject to the jurisdiction of the Commission, set forth in the various Supplements to the FPC Gas Rate Schedules listed in Appendix A hereto are just and reasonable, and these proceedings should be terminated.

The Commission orders:

(A) The increased rates for natural gas proposed herein and contained in the rate schedules set forth in Appendix A hereto, are hereby approved.

(B) The rate proponents listed in Appendix A hereto are hereby released from all obligations to make any refunds of the amounts of moneys collected under the rates and charges in effect under corporate undertakings since the dates such increased rates and charges became effective as also shown in Appendix A hereto, and the corporate undertakings under which such moneys have been collected are hereby discharged, except that Supplements 3, 4, 5, and 6 to Atlantic Refining Company's FPC Gas Rate Schedule No. 52, for which no motion has been filed to make it effective subject to refund, shall be permitted to go into effect upon the filing of an appropriate motion by that company.

(C) These proceedings are hereby terminated.

By the Commission. Commissioner Connole dissenting.

MICHAEL J. FARRELL,
Michael J. Farrell,
Acting Secretary.

* * *

KUYKENDALL, Chairman, concurring in the result:

I concur in the result, as it is now clear that these rates should not have been suspended.

JEROME K. KUYKENDALL, *Chairman*

* * *

DIGBY, Commissioner, concurring:

I concur in the results of the Commission's order and opinion in this proceeding and concur generally in what is said in this very forthright and realistic approach to the problems involved.

I do not believe that the Commission had legal authority to suspend these rates. In my opinion, the step-up in price did not constitute an increase under the Natural Gas Act or under the Commission's rules and regulations. The step-up was a periodic change in price, expressly provided for in the original contract between the contracting parties spelling out the exact amount of the increase and when and how it would become effective. The new price, in my opinion, is as much a part of the original rate or price as the earlier price provided in the contract.

In the Commission's order and opinion, it distinguishes the facts in this proceeding from those in the Union Oil case and other proceedings which were dismissed by the Commission. I feel that distinguishing between the issues and facts in these cases is unnecessary.

Further, I have never quite agreed that we are bound by the strict language of the City of Detroit case in rate considerations of independent producers and, even if we are, I feel that the Court, in the case of *Mississippi River Fuel Corp.* v. *F.P.C.*, __ F. 2d __ (CADC), certainly indicated that it had not intended to require a full-blown rate case as a point of departure in considering rate levels for producers.

S. L. DIGBY, Commissioner

* * *

COXNOLE, Commissioner, *dissenting:*

The dilemmas, the frustrations, the contradictions inherent in the effort effectively to apply the classic rate-base-rate-of-return concept to the administrative regula-

tion of producers' prices in a field with multiple ownership and control were never more apparent than here. And never have they been set out more clearly, nor has the issue of how we will dispose of them been delineated more arply.

For that reason, and because factually what majority says, of course, is entirely accurate, it is somewhat misleading to characterize my separate statement as a dissent. I differ, I do not dissent, in a matter of judgment only. My position, more properly, is that the reasoning of majority opinion does not lead inevitably to the conclusion that these rates in issue have been shown to be no more or less than just and reasonable. And, of course, Section 4 (a) says quite plainly that any rate or charge by a natural gas company "that is not just and reasonable is hereby declared to be unlawful." As a result, I feel bound by the statute and by applicable principles of rate making not to find these rates lawful unless the record contains the affirmative showing that they are just and reasonable. While the record contains much that proves the difficulty in judging rates on a rate-base-rate-of-return basis, there is not enough, in my judgment, to prove that, as a corollary, the rates have been shown just and reasonable. As a result the proceeding ought to be dismissed.

Majority recognizes this problem on mimeo page 13, but for reasons whose persuasive force I recognize but cannot follow, it reaches another result. I do not say the decision is categorically wrong. I do say the force of our primary obligation to protect the consumer moves in the other direction, despite the force of the arguments to the contrary. Briefly, here is why I so conclude.

Regardless whether these rates should have been suspended or not, they have been suspended and the order suspending their effectiveness and initiating the investigation stated that we would be concerned with "the law-

fulness of the said proposed changes." As a result, we have no choice except to make a determination one way or the other whether they are lawful. Inevitably, this determination has been made, and inevitably it must have been based on some major premises; it must derive validity from some sound general principles of rate making. The *Hope* case bromide (it is the "result reached and not the method employed which is controlling") has been cited as authority for a good many dubious propositions that could not be supported by logical analysis. However, I do not consider it stands for the proposition that the result itself need not be supported. My difficulty is finding that the reasons supporting the result here are appropriate or controlling.

Perhaps the result is just and reasonable. The difficulty is in determining what tests we should apply to find out and in determining whether the tests have been applied properly in this instance. In my judgment this record will not permit us to find any stable, meaningful landmarks and majority, in discarding rate-base-rate-of-return as a will-of-the-wisp, does not suggest what it has substituted in its place. At least it has not done so with enough certainty that I can reach the conclusion that respondent has sustained its burden of showing these rates are just and reasonable and hence lawful.

I believe the case should have been dismissed because the parties had failed to sustain their burden. While distinguishable on the base of difficulty in showing the applicability of a rate-base-rate-of-return, it is indistinguishable in the respondent has failed to show a compelling alternative. Accordingly, it should be disposed of as have any others in which the record suffered the same fatal defect.

It has always seemed to me that whatever means are settled upon to demonstrate the justness and reasonableness of rates the starting point must recognize, in some way, the "costs, including capital costs, incurred in render-

ing the service of exploring for, finding, reducing to possession and delivering to a buyer, the mineral resource known as natural gas."[1] For a more thorough discussion of my views on the applicability of so-called traditional rate making principles and the need for some consideration of revenue requirements for successful producer operation and regulation, see Georgetown Law Journal, Volume 44, No. 4, June, 1956. It is enough for the purposes of this statement that I see no useful alternative suggested in this case to the use of the classic rate-base-rate-of-return method, whatever are the defects of that method.

There are now depending several important and complete dockets in which the alternatives to the method rejected by majority are thoroughly canvassed. I prefer to await a record such as one in which I shall have ample and authoritative testimony and evidence before embracing one or the other, or abandoning all. Meanwhile, these rates should not be permitted to become effective, as it were, by default of respondent to prove its case one way and by default of ourselves to disprove it by any other.

WILLIAM R. CONNOLE

[1] Hearings before House Committee on H.R. 6790, H.R. 6791, 85th Congress, First Session, p. 1585.